IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 16 of 1992

For Approval and Signature:

HON'BLE MR.JUSTICE D.A.MEHTA
and
HON'BLE MS.JUSTICE H.N.DEVANI

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1. Whether Reporters of Local Papers may be allowed to see the judgements? : NO

2. To be referred to the Reporter or not? : YES

3. Whether Their Lordships wish to see the fair copy of the judgement? : NO

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder? : NO

5. Whether it is to be circulated to the concerned Magistrate/Magistrates,Judge/Judges,Tribunal/Tribunals? : NO

BHAGWATILAL G SHAH

Versus

COMMISSIONER OF INCOME TAX

Appearance:

1. INCOME TAX REFERENCE No. 16 of 1992
MR JP SHAH for Petitioner
MR MANISH R BHATT for Respondent

CORAM : HON'BLE MR.JUSTICE D.A.MEHTA
and
HON'BLE MS.JUSTICE H.N.DEVANI

Date of decision: 23/02/2005

ORAL JUDGEMENT

(Per : HON'BLE MR.JUSTICE D.A.MEHTA)

1. The Income Tax Appellate Tribunal, Ahmedabad Bench "A" has referred the following four questions for the opinion of this Court under Section 256(1) of the Income Tax Act, 1961 (the Act) at the instance of the assessee.

"(1) Whether on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the status of the assessee was not "Resident but not ordinarily Resident" and, therefore, the fees of Rs.14,860/- which has accrued outside India is not exempt under the proviso to section 5(1)(c) of the I.T.Act, 1961?

(2) Whether on the facts and in the circumstances of the case, the Tribunal was right in law in refusing deduction u/s 80-R of the I.T. Act, 1961 and whether its interpretation of section 80-R of the I.T. Act, 1961 and whether its interpretation of section 80-R is correct in law?

(3) Whether on the facts and in the circumstances of the case, the compensation of Rs.30,000/- being compensation paid by non-resident Mehta Group for loss of employment in India and "profit in lieu of salary" within the meaning of the expression in Section 17(3)(1) and, therefore, taxable as salary u/s 15?

(4) Whether the Tribunal was right in law in taxing in the hands of the assessee Rs.7,500/- paid to Advocate Shri Raval for his services in respect of Girnar Scooter Project?"

2. The learned advocate for the applicant, at the outset, states that he does not press questions No.1 and 2 under instructions. The said questions are, therefore, left unanswered.

3. The Assessment Year is 1982-83 and the relevant accounting period is the financial year ended on 31st March 1982. The assessee, an individual claimed an amount of Rs.30,000/- received as compensation as being not taxable under the Act in the return of income filed on 10th May 1982. The assessee had received fees from Gujarat Small Industries Corporation, Girnar Scooter Project a sum of Rs.15,000/- against which he had claimed deduction of an amount of Rs.7,500/- paid to one Shri N.U.Raval. The assessing officer brought the amount of Rs.30,000/- to tax and disallowed the claim of deduction

of Rs.7,500/-. The assessee carried the matter in appeal before the CIT (Appeals), who, for the reasons stated in his order dated 21st July 1987, held that the amount of Rs.30,000/- was rightly taxed as income under the head "salaries". In relation to the claim of deduction of Rs.7,500/-, the CIT (Appeals) confirmed the same by treating it as an application of income.

4. The assessee carried the matter in appeal before the Tribunal. In relation to the first issue, namely, compensation of Rs.30,000/-, the Tribunal held that the same was taxable under the head "salaries" being "profit in lieu of salary" within the meaning of Section 17(3)(i) of the Act. the Tribunal also upheld the disallowance of Rs.7,500/- holding that the income in question was assessed under the head "income from other sources" and hence, deduction, if any, was permissible only under Section 57(iii) of the Act. That, in the instant case, the assessee had already earned at least a part of the income before making payment and further that it was not proved that the amount was expended wholly and exclusively for the purposes of making or earning income from GSIC.

5. Mr.Manish J.Shah, the learned advocate appearing on behalf of the applicant - assessee has invited attention to provisions of Sections 15 and 17(1)(iv) and 17(3)(i) of the Act to contend that the requirement of the provision was not satisfied and in the circumstances, the amount of compensation of Rs.30,000/- was not taxable either under the head "salaries" or under any other head. He also invited attention to the amendment brought on the statute book with effect from 1st April 2002 by the Finance Act, 2001, whereunder Clause (iii) came to be inserted in Section 17(3) of the Act, to contend that, till 31st March 2002, any compensation received from a person other than an employer or a former employer, could not be treated as "profits in lieu of salary" so as to make it liable to tax under the head "salaries". In this context, he invited attention to the correspondence entered into by the assessee with the payer, namely, the Mehta Group International Limited, Projects Division, and submitted that, in the facts of the case, the revenue authorities and the Tribunal were not justified in bringing this amount of Rs.30,000/- to tax.

5.1 In relation to disallowance under Section 57(iii) of the Act, Mr.Shah contended that the receipt of Rs.15,000/- was taxed as income from other sources in hands of the assessee and therefore, the only limited question that the Tribunal was called upon to decide was

as to whether the sum of Rs.7,500/- paid to Mr.N.U.Raval was laid out or expended wholly and exclusively for the purposes of making or earning the income. It was submitted that the assessee was required to render consultation and opinion qua Girnar Scooter Project of GSIC which was having tax and other legal implications. That the assessee sought services of Mr.Raval, who was an expert in the field of taxation, so as to render a complete report to GSIC and the payment had been made for such services which were availed of from Mr.Raval. According to him, therefore, the expenditure had direct nexus with the earning of income and hence, the disallowance was wrongly made and confirmed.

6. Mr.M.R.Bhatt, the learned senior standing counsel appearing on behalf of the respondent submitted that the compensation which was received from the Mehta Group was towards termination of employment with Indian Institute of Management, Ahmedabad where the assessee was serving. He referred to communication dated 15th June 1981 (Annexure "J") to submit that the payer had called upon the assessee to relieve himself from the present engagement with Indian Institute of Management, Ahmedabad and be readily available for the assignment, and in consideration of such a course of action, the amount of Rs.30,000/- was paid. That in fact, the assessee had resigned in pursuance of the said communication. Therefore, according to him, once the purpose for which the compensation was paid became apparent, it had to be taxed as salary though termed as compensation, and the payment was in fact in substitution of the salary which the assessee would have received if he had not resigned from the Indian Institute of Management.

6.1 In relation to the payment made to Shri Raval, it was contended that the assessee had to establish that the payment was made wholly and exclusively for the purposes of earning income and the term "exclusively" would take within its sweep a situation whereby an assessee was required to make payment when the assessee had no option but to make the payment for the purposes of earning the income. It was submitted that, any payment made out of volition without there being any necessity could not fall within the parameters of Section 57(iii) of the Act so as to be treated as an allowable deduction. He placed reliance on the decision of this Court in the case of Kalindi Investment P. Ltd. v. Commissioner of Income Tax, (2003) 260 ITR 261.

7. Section 14 of the Act lays down the six heads under which all income is classified for the purposes of

charge of income tax and computation of total income under the Act. Under the head "salaries", Section 15 provides for the income which are chargeable to tax. Section 17 defines the terms "salary", "perquisite" and "profits in lieu of salary". At the relevant point of time, the phrase "profits in lieu of salary" was defined as under :

"17(3) "profits in lieu of salary" includes -

(i) the amount of any compensation due to or received by an assessee from his employer or former employer at or in connection with the termination of his employment or the modification of the terms and conditions relating thereto;

(ii) any payment (other than any payment referred to in clause (10), clause (10A), clause (10B), clause (11), clause (12) or clause (13A) of section 10), due to or received by an assessee from an employer or from a provident or other fund (not being an approved superannuation fund), to the extent to which it does not consist of contributions by the assessee or interest on such contributions."

On a plain reading of above provision, it is apparent that amount of any compensation which is due to an assessee or received by an assessee from an employer or a former employer at the time of termination of his employment or in connection with termination of his employment or the modification of the terms and conditions of his employment falls within the meaning of the phrase "profits in lieu of salary" and becomes liable to tax under Section 15 of the Act. In other words, the provision implies some sort of obligation to pay arising out of employment which is terminated or being terminated. Hence, the necessity of the payer being an employer or a former employer. The compensation paid / payable under this section is distinct from an ex-gratia payment made de hors an obligation incurred by an employer or a former employer.

8. Admittedly, as the facts of the case show, the assessee was employed with Indian Institute of Management and resigned with effect from 1st July 1981, as stated in letter of 27th June 1981. The assessee was negotiating an assignment / employment with the Mehta Group International Limited, Projects Division in the position

of the Group Finance Controller in Uganda, but on the day he tendered his resignation, he was not engaged by the said party. As letter dated 15th June 1981 shows, he was to make himself readily available for the assignment and the assignment was likely to be finalized before the end of calender year 1981. The sum of Rs.30,000/- was to be paid to the assessee in consideration of his making himself readily available for the assignment or in other words, for keeping himself in readiness to join the duty at short notice. It is on record that, in fact, the payment came to be made on 7th September 1981 and on that day, the assessee was not in employment either with Indian Institute of Management (former employer) or with anyone else, including the payer. Therefore, there was no employer. In the circumstances, on a plain reading of the provisions i.e. Section 17(3)(i) of the Act, it cannot be stated that the amount of Rs.30,000/- received as compensation by the assessee was to be treated as "profits in lieu of salary" and taxable under the head "salaries".

9. The following clause has been added to Section 17(3) of the Act with effect from 1st April 2002 :

"(iii) any amount due to or received, whether in lump sum or otherwise, by any assessee from any person -

(A) before his joining any employment with that person; or

(B) after cessation of his employment with that person."

This provision makes it abundantly clear that, till insertion of this clause, such an amount received by an assessee, namely from a person who is not an employer, either before or after cessation of employment with that person, is not taxable. In the circumstances, the Tribunal was not justified in holding that the amount of compensation was taxable under the head "salaries" within the meaning of the phrase "profits in lieu of salary".

10. In relation to the second claim, namely, allowability of sum of Rs.7,500/- paid to Shri N.U.Raval, the facts lie in a very narrow compass. The assessee was retained by Gujarat Small Industries Corporation for conducting a study and rendering his opinion on separation of Girnar Scooter Project as a separate company and such study report had to take within its fold

tax implications and financial requirements. The assessee accordingly received a sum of Rs.15,000/- from GSIC in two installments - Rs.9,000/- on 4-8-1981 and Rs.6,000/- on 24-10-1981. The assessee paid Rs.6,000/- on 5-8-1981 and Rs.1,500/- on 29-8-1981, totalling to Rs.7,500/- to Shri N.U.Raval for his advice on tax and legal implications of the said Project. The assessee claimed deduction of the aforesaid amount of Rs.7,500/-, which has been disallowed.

11. The amount of Rs.15,000/- has been brought to tax under the head "income from other sources" under Section 56 of the Act. In the circumstances, whether the amount of Rs.7,500/- can be allowed as a deduction is required to be tested in light of the provisions of Section 57(iii) of the Act. Section 57 states that the income chargeable under the head "income from other sources" shall be computed after making the specified deductions under various clauses and under clause (iii) a deduction is allowable of any other expenditure which is not in the nature of capital expenditure, is laid out or expended wholly and exclusively for the purpose of making or earning such income. In the case of Smt. Virmati Ramkrishna v. Commissioner of Income Tax, (1981) 131 ITR 659, this Court formulated as many as twelve tests after analyzing the statutory language and principles laid down in decided cases. Test No.(xii) lays down that the question whether the expenditure was laid out or expended for making or earning the income must be decided on the facts of each case, the final conclusion being one of law. Mr.Bhatt has placed reliance on Test No.(vi) to contend that only in case where the assessee has no option except to incur the expenditure, would the expenditure be treated as an allowable deduction. However, the said test is in context of expenditure incurred for preserving and maintaining the source of income. At the same time, it is not even the revenue's case that, on the exercise of option, the expenditure has no concern with the making or earning of income, and that the option depends upon personal considerations or motives of the assessee. Therefore, the conditions stipulated vide Test No.(vi) are not fulfilled.

12. Test No.(vii) states that it is not necessary that the expenditure incurred must have been obligatory, it is enough to show that the money was expended not of necessity but voluntarily and on the ground of commercial expediency and in order to facilitate the making or earning of the income. The present expenditure of Rs.7,500/- fulfills all the requirements of the aforesaid test as well as the other tests laid down by this Court

so as to be treated as an allowable expenditure. Hence, it is not possible to accept the finding of the Tribunal that the amount was application of income or that it was not expended wholly and exclusively for the purposes of making or earning income.

13. In the result, question No.3 is answered in the negative i.e. in favour of the assessee and against the revenue. Similarly, question No.4 is also answered in the negative i.e. in favour of the assessee and against the revenue. The Reference stands disposed of accordingly. There shall be no order as to costs.

[D.A.MEHTA, J.]

[H.N.DEVANI, J.]

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